No. 13105

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RAYMOND W. CLAWSON,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

PETITION FOR REHEARING.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Cases

Statutes

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On August 28, 1952, this Court, Judges Mathews, Bone and Orr, rendered an opinion affirming the judgment of conviction of appellant and the sentence of imprisonment for one year.

Appellant respectfully petitions this Court for rehearing in this case for the reasons: (1) the monetary facts in this case are different from those stated in the opinion, and (2) the procedural errors before the District Court are sufficiently grave and prejudicial to require reversal of the conviction.

1. The Facts.

In its Opinion, this Court in substance held that in 1946 appellant personally received gross income of more than $500, that Clawson Enterprises, Inc., was appellant's "dummy," that appellant received from this corporation some $20,377.35 as direct income, and received constructive dividends which he was under no obligation to repay.

All of these findings and conclusions stem from the basic conclusion that appellant received or used *as income for 1946* the funds set forth in the Opinion.

This is not an income tax evasion case; it is only a failure to file case. Nowhere does the Government claim that a single cent of taxes is owed by appellant. Certainly if appellant earned the income which is attributed to him, appellant could have been indicted for an attempt to defeat and evade the payment of taxes. This was never done, and at no time was any demand made for any taxes whatsoever.

(a) We respectfully submit that a complete recapitulation of the Government-adduced and uncontradicted oral and documentary defense evidence discloses that the moneys involved did not constitute income in 1946.

The Opinion recites (p. 3, third par.) that after March 1946, the corporation ceased to do business. We respectfully submit that the record shows that the corporation continued to do business for at least two years thereafter, and that it acquired other assets during the latter period.

Appellant testified without contradiction that the corporation continued to operate after March, 1946 [R. 600, 612]. The corporation's bank accounts show hundreds of withdrawals and deposits until May 20, 1948 [Exs. F and M, J, K, R].

The Government stipulated that the corporation was never dissolved [R. 243]. Government witnesses Hicks and Cummins testified that in 1946 corporation funds were used to purchase and outfit the boat "Artemis" [R. 287-288, 387-389, 558-559, 587, Ex. B, 5]; the corporation acquired and operated the newspaper "The Crenshaw Mirror" [R. 288, Exs. P-1, P-2, P-3, P-4, Q, S, T, 317-318, 458-459, 587-589, 616-618]. Some of the proceeds from the later sale of the "Artemis" were redeposited into the corporation's account [R. 402-403].

The corporation was duly organized and existed under the laws of the State of California, with by-laws, stock, etc. [T. R. 217, 545-547; Govt. Exs. 1, 1-B, 17, 18].

It had two active bank checking accounts which at times required two signatures for the withdrawal of funds [T. R. 546; Govt. Ex. 5; Deft. Exs. F, G, M, J, K]. It made hundreds of deposits and withdrawals totalling many thousands of dollars [T. R. 306-312; Govt. Exs. 20-22, 42-48; Deft. Exs. A-G, J, K, M]. It had books and records [Govt. Exs. 10, 11; T. R. 128-132, 199-210, 216, 297, 319-321, 542]. It had officers [T. R. 217, 244, 545-546] and numerous employees [T. R. 227, 244, 247; Deft. Exs. E-1 to E-5, H, I, L]. It engaged in various financial and commercial transactions, and paid numerous taxes [*E. G.,* Govt. Exs. 5, 6, 7, 10, 11, 20, 21, 22, 23, 24, 25, 26, 27, 41-A, 41-B, 42-48; Deft. Exs. B, C, D, E-1 to E-5, F, G, H, J, J-1, K, M, N, O].

This Court concluded in effect from the evidence (Opin. p. 4) that Clawson Enterprises, Inc., was a mere dummy, and held that "the fact, and not the form, is decisive," and that the facts in this case "are reminiscent of, but even stronger than" those in *Currier v. United States,*

166 F. 2d 346 (1948), 1 Cir., and held that appellant received constructive dividends from that corporation.

We respectfully submit that Clawson Enterprises, Inc., was created and functioned for a period of more than five years in a manner and is no different from hundreds of other family-owned corporations whose existence as such is recognized by the Commissioner of Internal Revenue and the courts.

See, *e. g.*,

Lynch v. Hornby, 38 S. Ct. 543;

Commissioners v. Court Holding Corp., 324 U. S. 331;

Commissioner v. Montgomery, 144 F. 2d 313;

Interstate Transit Lines v. Comm'r, 63 S. Ct. 1279;

Commissioner v. Modine Properties, 63 S. Ct. 1132;

Harwood v. Eaton, 68 F. 2d 12;

Pickwick Corp. v. Welch, 21 Fed. Supp. 664;

Old Colony Trust v. Comm'r, 69 F. 2d 699;

Corning Glass Works v. Comm'r, 9 B. T. A. 771;

Bancker v. Comm'r, 76 F. 2d 1;

Corning Glass Works v. Comm'r, 37 F. 2d 798;

Eichelberger v. Arlington Bldg., Inc., 280 Fed. 997.

See also,

Internal Revenue Code, Section 3797(a)(3).

The Opinion states in effect (pp. 2 and 3) that appellant utilized various funds, mainly from the sale of corporate assets.

We respectfully submit that this was not income to appellant; it constituted a partial repayment of the money he had advanced to the corporation in prior years, a total sum in excess of $45,000 [R. 555, 560-561, 610-611].

Appellant received no salary from the corporation whatsoever [R. 563]. Appellant testified, without contradiction, "I took money out sometime because I felt I could, because I put money into it, but that is all * * *" [R. 563]. Almost from its inception the corporation was operated at a loss [R. 251-252, 547, 606].

Uncontradicted testimony and record evidence demonstrated that between 1943 and 1946, appellant loaned to the corporation more than $45,000, much of which was in part deposited into the corporation's bank accounts at the Citizens Bank and the Security-First National Bank, and a great part of which appellant paid directly out of his own pocket for the benefit of the corporation and as loans to it [R. 254-255, 306, 548-549, 552, 580-587, 594-598, 600, 606, 640, Exs. F, H, M].

This money was obtained by appellant [R. 542] in the main by gifts from his grandmother (who had supplied him with money for many years) [R. 253-254, 329-330, 337-339, 474-477, 529]; by loans from his prior wife, Phyllis Clawson, in the sum of approximately $15,000 [R. 479-480, 555-557] and for which she received the corporation's receipts [R. 490, 533]; by loans from his then-wife, Kathleen, in the sum of approximately $20,000 [R. 252-253, 338-339, 530, 532, 548, 565-567, 582, 672-673]; loans and remittances from his mother, in the sum of approximately $16,000-$17,000 [R. 513, 516-517, 254, 435-449, 474]; loans from lending institutions, including the Auto Finance Co., Markwell & Co., and Sunset &

Vine Loan Co., to himself and to his wife mainly for the benefit and use of the corporation [R. 565-566], and loans from outsiders [R. 253].

These outsiders included, among others, witness Mrs. Julia Rudd, who, it is undisputed, in 1945 lent appellant about $11,500, and in 1946 about $900, to be used in his business [497, 499-500, 543].

And the Superintendent of Postal Telegraph and Cable Co. at Oakland testified without contradiction that appellant's mother remitted to him many thousands of dollars each year beginning in about 1933 [435-449]. Appellant's mother had been given this money by her mother, appellant's grandmother, for transmittal to him [512, 522]. The total sums thus transmitted to appellant were between $125,000 and $150,000 [R. 513, 523].

In fact, appellant was later made the subject of an information on charges of violating the Corporate Securities Act, etc., in the Superior Court, County of Los Angeles as a result of his and Clawson Enterprises, Inc.'s borrowing money, and their inability to repay such loans in 1947. The case was later dismissed upon arrangements being made to repay those loans. (Superior Court, L. A. County, Case No. 130571.)

Appellant, in utilizing or disbursing corporate funds, did so on behalf of the corporation, in repayment of its debts to appellant and the others who had loaned money for its operations.

The proceeds of the sale of the restaurant were utilized as follows:

> $9,500 as a further payment on the Artemis on behalf of the corporation [R. 568-570, Exs. 8-A, 8-B].

$3,000 redeposited into the corporation's account [R. 577, 580, 584-585, Ex. 36].

$5,000 for furniture and for Phyllis Clawson [R. 578, Ex. 37] in partial repayment of the $15,000 (*supra*) she advanced for the operations of the corporation [R. 578, Ex. 37].

$3,350 to appellant [R. 580, Ex. 37] in partial repayment of the $44,000 he had loaned to the corporation.

The proceeds of the sale of the "Artemis" were distributed as follows:

$8,000 to Kathleen Clawson in repayment of funds advanced by her to the corporation [571-572, Ex. 30].

$25,000 deposited to the account of the corporation [R. 573, 575, 576, Exs. 31-A, 33-A].

$8,000 paid to Vine-Sunset Loan Co. to pay off loans made by Kathleen Clawson, Phyllis Clawson and appellant, the proceeds of which had been used in connection with the operations of the corporation [R. 573-574].

$8,000 to Markwell & Co. in repayment of loans made by her the proceeds of which were loaned to the corporation [R. 596].

$10,000 to Auto Finance Company to repay loan the proceeds of which were used for the corporation [R. 574-575, 596].

Appellant otherwise utilized the remaining $7,750. But the corporation owed him more than $44,000 (*supra*). Therefore this $7,750 did not constitute income to appellant.

Where did appellant obtain funds for his personal living expenses? Partly from the corporation after the sale of the restaurant (*supra* and *infra*) and partly from his then wife, Katherine Clawson, who was the beneficiary of a trust estate, No. B-919, Security-First National Bank of Los Angeles, Sixth and Spring Streets, from which she received about $80,000 while married to appellant [R. 531, 619, 672-675, 676, 679, 684-685].

The total funds taken by appellant from the corporation for his own use did not at any time even approximate the indebtedness of the corporation to him, of about $44,000. The funds taken by appellant from the corporation to repay other persons who had advanced money for its operations, were repaid on behalf of the corporation, and, we respectfully submit, cannot be considered as income to appellant.

2. Procedure.

In its Opinion, this Court stated that all other errors specified by appellant are without merit. Petitioner respectfully requests reconsideration of this conclusion.

A. Appellant sought by motion a bill of particulars; the motion was denied [Cr. 4-8].

Had appellant been furnished a bill of particulars, he could have met various issues which were raised for the first time at the trial, including the mutually-exclusive theories of the prosecution as to the corporate income of Clawson Enterprises, Inc., constituting (1) direct income to appellant under the *alter ego* theory and (2) indirect income to appellant under the constructive dividend theory. Not until almost the very end of the trial in this case did the Government reveal its position that it was trying a constructive dividend case, rather than an *alter ego* case.

In fact, much damaging evidence which was proper under the *alter ego* theory, but not the constructive dividend theory, was admitted.

B. The testimony of Dr. George D. Whitecotton [Tr. 647-665] and the medical records [Govt. Exs. 52-54] were purely second-degree hearsay evidence not relating to appellant but *to his grandmother.*

This hearsay testimony was highly prejudicial to appellant and should not have been admitted, since it constituted an attempt to contradict indirectly his and other witnesses' testimony to the effect that he and his wife had borrowed or received extensive funds from his grandmother which were thereafter loaned by him and his wife to Clawson Enterprises, Inc., as to which he later received repayment. These repayments of loans were part of the sums credited by the Government to appellant personally as income.

Moreover, the trial judge refused to grant a continuance to permit appellant to gather evidence to rebut this surprise hearsay testimony.

C. Various instructions given by the trial court should not have been given, we submit. Others offered by appellant and rejected by the trial court were essential to his case. In both sets of instances appellant was gravely prejudiced to an extent requiring reversal of his conviction. We point to but a few instances selected from many set forth in our main brief.

(a) Government's Instruction No. 2.

> "If you find that there were any gains, profits, or income received by the defendant which were not reported, *it makes no difference as far as the question of taxability is concerned whether such income was lawfully received or unlawfully received, inasmuch*

as both were taxable and should have been reported." (Italics added.)

We respectfully submit that this is not the law (*Commissioner v. Wilcox,* 66 S. Ct. 546). Plainly the jury was misinstructed here and its verdict could have been predicated upon acceptance and application of this instruction.

(b) Government's Instruction No. 9.

"Every person subject to income tax, 'except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, *shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters* required to be shown' in an income tax return."

No issue is present in this case as to failure to "keep such permanent books of account or records * * *" etc. Wilful failure to comply with this regulation can be the basis of a criminal prosecution. However, it was not the basis of the instant prosecution. The jury plainly could have been led to believe by this instruction that failure to keep sufficient books was the gravamen of the offense.

(c) Government's Instruction No. 10.

" 'Wilful,' in the statute which makes a wilful attempt *to evade taxes* a crime, refers to the state of mind in which the act of evasion was done. * * *"

This was not a tax evasion case under Section 145(b) of the Internal Revenue Code. The language quoted

could easily have misled the jury as to the issues before it, and may have been responsible for the conviction in this case.

(d) Defendant's Instruction No. 3.

"It is immaterial whether or not Clawson Enterprises, Inc., had any income during 1946" [C. T. 17].

(e) Defendant's Instruction No. 9.

"Nor can the receipts of a corporation be chargeable to its stockholders or sole stockholder for income tax purposes" [C. T. 17].

Clawson Enterprises, Inc., was not on trial; its *income* had no bearing on this case. The voluminous testimony as to the corporation's income, based on the *alter ego* theory subsequently disavowed by the prosecution, prejudicially confused the jury as to the issues before it, namely whether appellant *as an individual* had a gross income requiring the filing of an individual income tax return by him.

(f) Defendant's Instruction No. 12.

"You cannot find that the defendant acted wilfully if he did not understand clearly the requirements of the law as they applied to him in connection with income tax returns for 1946" [C. T. 17].

(g) Defendant's Instruction No. 13.

"You cannot find that the defendant acted wilfully if he is shown to have honestly believed that under the circumstances presented in this case he did not have to file any return for 1946, or if he relied upon the advice of an accountant or an attorney as to his rights and obligations in that regard" [C. T. 18].

These instructions were essential to clarify the wilfulness element of the case. Appellant was clearly confused as to his duties in the premises. He believed that no return was required unless he had net income—and there was no net income. The jury should have been instructed on the law relating to appellant's defense.

(h) Defendant's Instruction No. 18.

"Money misappropriated, embezzled or stolen does not constitute income, either gross or net, to the person who misappropriates, embezzles or steals the money in question" [C. T. 18].

This instruction paraphrases the Supreme Court's holding in *Commissioner v. Wilcox* (1946), 327 U. S. 404, 66 S. Ct. 546. Appellant was entitled to have the jury instructed as to all the law applicable to him under the facts which the jury may have found to exist. (See also Govt. Instr. No. 2, *supra.*)

(i) Defendant's Requested Instruction No. 28.

"The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity" [C. T. 23-24].

(j) Defendant's Requested Instruction No. 29.

"The corporate form must be unreal or a sham before the Treasury may disregard it. Whatever may have been the purpose of organizing the corporation,

so long as that purpose is the equivalent of business activity, or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity" [C. T. 24].

These rejected instructions correctly reflect those principles of law which are favorable to appellant (see cases cited above). Indeed, the instructions given did not present the law as it applied to the divergent views as to the facts before the jury.

We respectfully submit that the instructions sought by appellant should have been given, and those objected to should not have been placed before the jury.

Conclusion.

Appellant respectfully submits that this petition for rehearing should be granted, and that upon such rehearing the judgment below should be reversed.

RAYMOND W. CLAWSON,
Petitioner.

WILLIAM STRONG,
Attorney for Petitioner.

Certificate of Counsel.

I certify that in my judgment this petition is well-founded and is not interposed for delay.

WILLIAM STRONG.